Supreme Court, U.S.
FILED
FEB 22 2000
CLERK

(2)

No. 99-1214

IN THE

Supreme Court of the United States

CATERPILLAR INC., CATERPILLAR FINANCIAL SERVICES CORPORATION, AND SOLAR TURBINES INCORPORATED,

Petitioners,

v.

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, JR., THE N.H. COMMISSIONER OF REVENUE,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, COMMISSIONER

PHILIP T. MCLAUGHLIN
Attorney General
STEPHEN J. JUDGE*
Associate Attorney General
ANNE M. EDWARDS
Assistant Attorney General
Civil Bureau
N.H. Department of Justice
33 Capitol Street
Concord, New Hampshire
03301-6397
(603) 271-3658

JOHN F. HAYES
Revenue Counsel
N.H. Department of
Revenue Administration
45 Chenell Drive
Concord, New Hampshire
03302-0457
(603) 271-3400

Counsel for Respondents
* *Counsel of Record*

February 22, 2000

52pp

RESTATED QUESTION PRESENTED

1. Does the New Hampshire Business Profits Tax discriminate against foreign commerce because of the requirement of "water's edge" combination, which includes (a) the net income and (b) the factors only of the water's edge (i.e., domestic) members of a unitary group of businesses in calculating the group's tax base and the percentage of the group's income that will be taxed by New Hampshire, respectively, which does not include the net income and factors of any other entity regardless of location, including the foreign members of the larger unitary group, in determining the group's tax base and apportionment percentage?

TABLE OF CONTENTS

	Page
RESTATED QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
BRIEF IN OPPOSITION	1
STATEMENT OF THE CASE	1
A. Supplemental Facts	2
B. Determining The Tax Base Under The Business Profits Tax.	3
C. Calculating The Apportionment Percentage.	4
D. Royalty And Interest Payments Received By Combined Members Of A Unitary Group From Uncombined Unitary Foreign Subsidiaries.	5
E. Proceedings Below.	8
REASONS FOR DENYING THE PETITION	9
I. The Petition Should Be Denied As *Certiorari* Was Denied On This Identical Question.	9
II. Petitioners Failed To Establish That The New Hampshire Business Profits Tax Facially Discriminates Against Foreign Commerce In Violation Of The Foreign Commerce Clause.	11
A. The Established Standards.	11
B. The New Hampshire Supreme Court Applied The Standards Established By This Court And Correctly Held That Petitioners Did Not Show That Facial Discrimination Exists.	12

Page

C. Petitioners' Arguments Are Based On The Flawed Premise That All Payments From Foreign Subsidiaries To Members Of The Water's Edge Group Are Made Because Of The Group's Ownership And Control Of Those Subsidiaries. 16

1. There Is No Factual Basis In The Record For Petitioners' Assertion That Royalty And Interest Payments Repatriate Unitary Income From Its Foreign Subsidiaries. 17

2. There Is No Basis In Law For Petitioners' Assumption That Royalty And Interest Payments Have The Same Character As Dividends. 17

III. The New Hampshire Supreme Court's Decision Does Not Conflict With Decisions Of Other State Appellate Courts. 19

IV. New Hampshire's Non-Discriminatory, But Different, Accounting For Foreign And Domestic Subsidiaries Is Justified. 20

CONCLUSION 23

APPENDICES:

Appendix A: Selected Paragraphs from Stipulation of Facts dated July 19, 1995 ..... 1a

Appendix B: NH. Rev. Stat. Ann. §77-A:6 (1996) 6a

Appendix C: Examples of How to Calculate the New Hampshire Business Profits Tax that were submitted to the New Hampshire Supreme Court 9a

TABLE OF AUTHORITIES

	Page
Armco, Inc. v. Hardesty, 467 U.S. 638 (1984)	12
ASARCO Inc. v Idaho State Tax Comm'n, 458 U.S. 307 (1982)	14
Barclays Bank PLC v. Franchise Tax Board, 512 U. S. 298 (1994)	11, 12, 21
Caterpillar Financial Services Corp. v. Whitley, 680 N.E.2d 1082 (Ill. Ct. App.), *appeal denied*, 686 N.E.2d 1158 (Ill. 1997)	5, 19, 20
Caterpillar, Inc. v. Commissioner of Revenue, 568 N.W.2d 695 (Minn. 1997), *cert. denied*, 118 S. Ct. 1043 (1998)	10, 17 19, 20
Caterpillar, Inc., et.al., v. N.H. Department of Revenue Admin., et.al., 741 A. 2d 56 (1999)	passim
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)	8, 11
Conoco, Inc. v. Taxation & Revenue Department, 931 P.2d 730 (N.M. 1996)	19
Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983)	21
Dart Industries, Inc. v. Clark, 657 A.2d 1062 (R.I. 1995)	19
E.I. Du Pont de Nemours & Co. v. State Tax Assessor, 675 A. 2d 82 (Me. 1999)	20
Hughes v. Oklahoma, 441 U.S. 322 (1979)	12

	Page
In re Morton Thiokol, Inc., 864 P. 2d 1175 (Kan. 1993)	20
Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance, 505 U.S. 71 (1992)	passim
Maryland v. Louisiana, 451 U.S. 725 (1981)	12, 15
Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1990)	8
Norton Co. v. Department of Revenue, 340 U.S. 534 (1951)	12
Opinion of the Justices, 128 N.H. 1 (1986)	6
Quill Corp. v. North Dakota, 504 U.S. 298 (1992)	11
Statutes	
26 U.S.C. § 61	18
26 U.S.C. § 162, 163	18
26 U.S.C. §§ 881-885	21
Minn. Stat. § 290.19	10
N.H. Rev. Stat. Ann. 77-A:1, III(a)	6
N.H. Rev. Stat. Ann. 77-A:1, XIV	6
N.H. Rev. Stat. Ann. 77-A:1, XV	7
N.H. Rev. Stat. Ann. 77-A:1, XIX	7
N.H. Rev. Stat. Ann. 77-A:3, I(c)	10
N.H. Rev. Stat. Ann. 77-A:3, II(b)	7
N.H. Rev. Stat. Ann. 77-A:6, IV	6

Page

Other Authorities

Donald E. Kieso and Jerry J. Weygandt, *Intermediate Accounting* (4th ed. 1983) 18

1 Jerome R. Hellerstein and Walter Hellerstein, State Taxation (2nd ed. 1993) 22

Black's Law Dictionary (4th ed. 1968) 18

CCH State TaxGuide, Vol. 1 22

CCH State Reporter, Alaska 22

IN THE
Supreme Court of the United States

CATERPILLAR INC., CATERPILLAR FINANCIAL SERVICES CORPORATION, AND SOLAR TURBINES INCORPORATED,

Petitioners,

v.

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, JR., THE NEW HAMPSHIRE COMMISSIONER OF REVENUE,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION

Respondents respectfully request that this Court deny the Petition for Writ of *Certiorari* (the "Petition") seeking review of the decision of the New Hampshire Supreme Court in this case. While there is not yet an official reported version of the decision below, it is reported as *Caterpillar Inc., Caterpillar Financial Services Corporation, and Solar Turbines Incorporated v. New Hampshire Department of Revenue Administration and Stanley R. Arnold, Jr., New Hampshire Commissioner of Revenue,* at 741 A.2d 56 (1999) and at 1999 N.H. Lexis 106.[1] (*"Caterpillar (N.H.)"*).

STATEMENT OF THE CASE

Respondents (the "State") submit the following additional information to supplement and correct Petitioners' statements of fact, descriptions of New Hampshire's business tax system, and the proceedings below.

[1] Petitioners have included a copy of the New Hampshire Supreme Court's decision in their Appendix beginning at 1a. In this Brief, Respondents will cite to items included in Petitioners' Appendix by referring to "Petitioners' App." and then the page number.

A. Supplemental Facts.

As Petitioners stated, the facts of this case, which were stipulated to, are not in dispute. Even though Petitioners have generally summarized accurately the pertinent facts regarding the organization and operation of their business, certain additional stipulated facts are necessary for the proper analysis of the issues in this case. Also, although the State generally agrees with Petitioners' background description of the State's application of the unitary tax system, there are some important errors and omissions that should be noted.[2]

The State does not agree with the tax example outlined in the Petitioners' Statement of the case as it does not reflect a realistic situation and does not accurately explain the workings of the water's edge combination under the New Hampshire Business Profits Tax (the "Business Profits Tax"). For example, the hypothetical $300 million dollar payments by Subsidiary Y would be reflected in Company A's apportionment formula in the denominator of the sales factor. As a result, only a fraction of the payment would be apportioned to New Hampshire. Thus, without knowing all of A's income and factors, it is impossible to determine the overall effect of Y's payment on A's tax obligation to New Hampshire and whether the obligation would be greater or less than if Y were a domestic subsidiary.

Also, Footnote 1 included in the Petition is an inaccurate reflection of how the Business Profits Tax works. Under the Business Profits Tax, payment to a parent by a domestic unitary subsidiary is included as income in the combined amount, however, it is offset by the expense recognized by the subsidiary. As explained further below, the concepts of

---

[2] Of course, the State does not subscribe to the conclusory comments regarding the alleged overstatement of income and the discriminatory treatment of the State's water's edge system included in the Petitioners' Statement of the case.

"shifting back" or "elimination" are relevant to the calculation of a taxpayer group's apportionment percentage, not to the calculation of the group's tax base. The result is that the transaction is essentially invisible for purposes of calculating the tax base.

B. Determining The Tax Base Under The Business Profits Tax.

The apportionable tax base for a unitary group of business organizations in New Hampshire is determined by the "water's edge method" of combined reporting. This method requires the combining of the net incomes (or losses), based on federal taxable income, of the members of the unitary group, except "overseas business corporations" (hereinafter "foreign corporations" or "foreign subsidiaries").

Because the apportionable tax base is the income of the combined group as a whole, transactions between members of the combined group do not affect the group's combined income. When a subsidiary pays royalties and interest to its parent, the income recognized by the parent is offset by the expense recognized by the subsidiary, thus making the transaction invisible for purposes of calculating the tax base. The apportionable tax base of the combined group includes any income received from a party outside the combined group and any expense paid to a party outside the combined group – income is added; expenses are subtracted. Because foreign corporations (whether unitary or not) are not part of the combined group, royalties and interest received by the group from foreign corporations, as well as expenses paid to foreign corporations, are added and subtracted, as appropriate, in computing the tax base of the group, as are transactions with unrelated third parties.

The apportionable tax base is allocated to the State using an apportionment percentage computed under a three-fac-

tor apportionment formula. The "water's edge group's" New Hampshire property, payroll, and sales are divided respectively by the total property, payroll and sales of all business organizations included in the combined group, *i.e.*, all unitary domestic corporations. The average of these fractions is the apportionment percentage.

The income taxed by the State is determined by multiplying the apportionment percentage by the combined net income of the water's edge group. Because the net income recorded by a foreign corporation is not included in the water's edge group's tax base, none of the foreign corporation's income is, or can be, apportioned to the State through the apportionment formula. Similarly, because the net income of the foreign corporation is not included in the combined group's tax base, the property, payroll, and sales factors of the foreign corporation are not used to apportion the income of the combined group among the states in which the members do business.

C. Calculating The Apportionment Percentage.

The next step in the process is calculating the percentage of the tax base apportioned to New Hampshire. Intercompany payments such as royalties and interest are not separately identified or treated in determining the aggregate tax base in a combined return. Since the aggregation (or "combination") of the base occurs at the level of net income, these payments are invisible: A receipt to one entity in the group is another's deduction. Therefore, no actual "elimination" of the payment takes place.

In calculating the combined apportionment percentage, however, such payments of royalties and interest must be eliminated from the combined sales factor by a tax accounting entry in order to avoid double counting. The combined sales factor is derived from aggregating *gross* receipts with-

out taking into account any deductions. This is because the factor is intended to be part of a calculation to approximate business activity in the state, not profit. Because there is no corresponding deduction on the part of the payor entity, absent such elimination, the sales factor would not accurately reflect the activity within or without the state. *See* Example 3, at App. 12a-13a (illustration of the calculation of the tax base and apportionment factors of a unitary business group with intercompany payments).[3]

D. Royalty And Interest Payments Received By Combined Members Of A Unitary Group From Uncombined Unitary Foreign Subsidiaries.

The focus of the Foreign Commerce Clause dispute in this case is the treatment accorded royalty and interest payments received by some of the combined members of Petitioners' water's edge group from uncombined unitary foreign subsidiaries. The royalty payments were in exchange for licenses to use trademarks and technology owned and developed by Caterpillar Inc. ("Caterpillar") or other combined members of the unitary group. Stipulation of Facts ¶ 10, at App. 2a ("Stip. ¶ ___"). The interest payments were in return for loans made to the uncombined foreign subsidiaries by the members of the combined group. Stip. ¶ 10. Caterpillar and certain combined group members also received intercompany royalties and interest payments from some of the other domestic members of the group. Caterpillar may also have received royalties from unrelated foreign and domestic third parties to whom it licensed trademarks and technology. *See Caterpillar Fin. Servs. Corp. v. Whitley*, 288 Ill. App. 3d 389, 680 N.E.2d 1082, 1083 (App. Ct. 3d Dist.), *appeal denied*, 174 Ill. 2d 556, 686 N.E.2d 1158 (1997).

---

[3] A short explanation of the workings of the New Hampshire Business Profits Tax is included in the Appendix to this Brief which shows, among other things, how to calculate a tax base and an apportionment percentage.

The uncombined foreign subsidiaries deducted the royalty and interest paid to Caterpillar on their respective foreign income tax returns.[4] Stip. ¶ 15, at App. 3a-4a. Caterpillar and any combined members of its group receiving such payments would include them as gross receipts on their federal income tax return. Stip. ¶ 15.

There are some serious flaws in Petitioners' description of the New Hampshire system of taxing unitary businesses with foreign subsidiaries. The Business Profits Tax is a net income tax. That is, the base upon which the tax is imposed is the current earnings remaining after adding all receipts from whatever source and deducting all expenses and losses. These current earnings are called "gross business profits," the basic element of which is federal taxable income. *See* N.H. Rev. Stat. Ann. § 77-A:1, III(a), at Petitioners' App. 37a. Royalty and interest receipts are not separately identified in the tax base, but only become a part thereof to the extent that income exceeds deductions in determining net income.

In order to comply with United States Constitutional constraints on the taxation of extraterritorial income, the Business Profits Tax statute "apportions" total net income based on a three-factor formula consisting of sales, payroll and property. *See Opinion of the Justices*, 128 N.H. 1 (1986). In the case of several legally discrete businesses operating as an functionally integrated unit – that is, business organizations satisfying the definition of a "unitary business" in N.H. Rev. Stat. Ann. § 77-A:1, XIV – the statute requires that the group file a combined return aggregating each members net income and apportionment factors. *See* N.H. Rev. Stat. Ann. § 77-A:6, IV, at App. 6a.

A system of taxation that aggregates the net incomes and factors of every member of the unitary business group wher-

---

[4] Just as any of the other domestic or unrelated third party payors would have done.

ever located is called "worldwide combination." Until 1986, this was New Hampshire's taxing system. In that year, the New Hampshire Legislature adopted the current modified system known as "water's edge combination." In the water's edge system, certain foreign companies, designated "overseas business organizations," are excluded from the combined group notwithstanding that they may otherwise qualify as unitary members. *See* N.H. Rev. Stat. Ann. § 77-A:1, XV and XIX, at Petitioners' App. 42a - 44a. The foreign companies' net income is not included in determining the water's edge group's tax base, and these companies' property, payroll and sales are likewise excluded from the calculation of the water's edge group's apportionment percentage. In effect, these foreign companies are treated as if they were unrelated to the group and intercompany payments, such as royalties and interest, are handled no differently than if they were made by unrelated third parties.[5]

Like any other payment from an unrelated party, royalties and interest received from foreign companies are included in gross receipts before deductions on the recipient's federal income tax return and, thus, flow into the water's edge group's preapportionment tax base. Such payments are also reflected in the group's sales apportionment factor. Since the payor is not domiciled in New Hampshire, the source of the receipt is extraterritorial and is included only in the denominator of the sales factor. The reflection of such payments in the denominator of the sales factor decreases the percentage of the combined group's income that is apportioned to New

---

[5] Royalties and interest are not the only intercompany transactions handled this way; so, too, are payments for goods, services, and rents. Certain intercompany distributions of retained earnings, *i.e.*, foreign dividends, are given special treatment by the business profits tax. *See* N.H. Rev. Stat. Ann. § 77-A:3, II(b), at Petitioners' App. 52a. With the filing of their Second Amended Petition, Petitioners abandoned any claim they had with respect to such dividends and elected to pursue only the issue of royalties and interest.

Hampshire. Petitioners' error is that they fail to include these payments at all. The process – calculation of the group's tax base, apportionment percentage, and tax – is demonstrated in Example 4, at App. 14a-15a.

E. Proceedings Below.

Clarification of the Petitioners' description of the proceedings below is necessary for the Court to rule on this Petition. Clarification is needed because the Petition alleges violations of the Due Process and Commerce Clauses that were not heard by the lower courts because the Petitioners abandoned such claims at the trial court level.

At the trial court, the Petitioners based their constitutional claim solely on the third prong of the four prong test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977): nondiscrimination against interstate (foreign) commerce. However, before this Court, Petitioners are attempting to substantially broaden their claims to encompass alleged violations of the Due Process Clause[6] and the first ("substantial nexus") and second ("fair apportionment") prongs of *Complete Auto*.[7] *See* Petition at 19–22. The issues in this case were framed for the Merrimack County Superior Court in the Petitioners' Second Amended Petition which raised three counts for the court's determination: Count I – Department of Rev-

---

[6] "For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a "minimal connection" between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the intrastate values of the enterprise," *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1990) (citations omitted).

[7] A tax (1) must be applied to an activity with a substantial nexus with the taxing state; (2) must be fairly apportioned; (3) may not discriminate against interstate commerce; and (4) must be fairly related to the services provided by the state. *Complete Auto*, 430 U.S. at 287.

enue Administration's actions discriminate against foreign commerce; Count II – statutory request for modification of the formula; and Count III – violation of 42 U.S.C. 1983.

Although Petitioners attempt to slide into their "fair apportionment," "substantial nexus," and Due Process claims through their facial discrimination argument, these claims were never raised at the trial court level and this Court should not entertain them here.

Finally, in the New Hampshire Supreme Court, Petitioners strenuously argued that royalties and interest received from foreign subsidiaries are actually "repatriations" of "income earned" by those foreign companies, *i.e.*, dividend substitutions. That argument was belied by the Stipulation of Facts which states that Caterpillar and other of its domestic subsidiaries licensed intangible or intellectual property or loaned money to such companies. *See* Stip. ¶ 10, at App. 2a. This argument, while not openly expressed in the Petition, appears to be assumed. Petitioners have "assumed" this characterization of royalties and interest received from foreign subsidiaries because the "repatriation" notion is fundamental to the logic through which Petitioners construct their argument for discriminatory treatment. That characterization is not supported by the facts in this case, nor is it established by law. And, since Petitioners appear to have abandoned their "repatriation" argument, they are barred from raising it now.

REASONS FOR DENYING THE PETITION

I. The Petition Should Be Denied As *Certiorari* Was Denied On This Identical Question.

The essence of the Petition is that the New Hampshire Supreme Court misapplied Footnote 23 of *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 505

U.S. 71, 80 (1992), and did not apply the proper test to determine whether there is impermissible discrimination under the Foreign Commerce Clause. The Petition should be denied as this identical issue was submitted to this Court by Petitioner Caterpillar against the State of Minnesota and *certiorari* was denied in that case. *See Caterpillar, Inc. v. Commissioner of Revenue*, 568 N.W.2d 695 (Minn. 1997), *cert. denied*, 118 S. Ct. 1043 (1998) ("*Caterpillar (Minn.)*").

The Minnesota Franchise Tax and New Hampshire's Business Profits Tax are, in relevant part, the same. Both require only unitary domestic subsidiaries' net incomes and apportionment factors to be combined; foreign subsidiaries or affiliates, unitary or not, are treated as if they were unrelated persons.[8] *Caterpillar (Minn.)*, 568 N.W.2d at 699. The Minnesota court found that the state's water's edge system did not "facially discriminate or unduly burden foreign commerce." *Id.* at 701. In so doing, it distinguished the holding in *Kraft*:

> *Kraft* was a relatively easy case for the [U.S. Supreme] Court to decide because Iowa used a separate entity reporting method, . . . thus, the Court could directly compare Iowa's treatment of dividends received from two separate entities, i.e., the domestic subsidiary and the foreign subsidiary. However, in this case, we are concerned with *combined* reporting, not single entity reporting, and

---

[8] New Hampshire's sales apportionment provisions do differ slightly from Minnesota's. In Minnesota, the amount of the royalties and interest received from unitary foreign subsidiaries or unrelated foreign or domestic payors is not included in the sales factor. Only sales of tangible property are used to measure sales activity. *See* Minn. Stat. § 290.19. In New Hampshire such amounts are always included in the denominator of the sales factor. *See* N.H. Rev. Stat. Ann. § 77-A:3, I(c), at Petitioners' App. 53a; and Example 4, at App. 14a-15a. That difference does not in any way affect the applicability of the Minnesota decision to this case.

> thus must look at the entire apportionment formula rather than simply the treatment of interest and royalties.

Id. at 701 (emphasis in the original; citations omitted).

When Petitioner Caterpillar challenged the Minnesota Supreme Court's ruling on the identical issue raised in this Petition, this Court denied review. There have been no intervening decisions that have created a conflict among the state courts since this Court denied review of the Minnesota Supreme Court's ruling. Thus, this Court should deny review in this case.

II. Petitioners Failed To Establish That The New Hampshire Business Profits Tax Facially Discriminates Against Foreign Commerce In Violation Of The Foreign Commerce Clause.

Petitioners allege that the Business Profits Tax facially discriminates against foreign commerce. Petitioners' claim rests entirely upon the non-discrimination component of Foreign Commerce Clause jurisprudence. Petitioners however do not apply the standards established by this Court to determine whether a tax discriminates against foreign commerce. The court below did apply the proper standards and correctly determined that Petitioners did not show that discrimination exists.

A. The Established Standards.

The non-discrimination component of Foreign Commerce Clause jurisprudence has been recently considered and applied in *Barclays Bank PLC v. Franchise Tax Board*, 512 U.S. 298, 310-11 (1994) (citing *Complete Auto*, 430 U.S. at 279). The non-discrimination component prohibits "taxes that pass an unfair share of the tax burden onto interstate [foreign] commerce," *Quill Corp. v. North Dakota*, 504 U.S. 298, 313

(1992), or taxes that "systematically 'overtax[ ]' foreign corporation." *Barclays*, 512 U.S. at 314. A law is discriminatory if it taxes interstate commerce more heavily than intrastate commerce, *see Armco, Inc. v. Hardesty*, 467 U.S. 638, 642 (1984), or foreign commerce more heavily than domestic commerce, *see Kraft*, 505 U.S. at 79-80.

In determining whether foreign commerce is more heavily taxed, a court must consider "the operation of other provisions of the . . . statute" under review. *Kraft*, 505 U.S. at 80-81 (quoting *amicus* brief of the United States with approval); *see also Maryland v. Louisiana*, 451 U.S. 725, 756 (1981) (a tax must be evaluated in light of the other provisions of the tax scheme). Further, this Court has specifically stated that the correct comparison to be made in cases like this one is between taxpayers who are the "most similarly situated." *See Kraft*, 505 U.S. at 80 n.23.

Finally, the burden of showing that foreign commerce is more heavily taxed is on the party claiming discrimination. *See Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979); *Norton Co. v. Department of Revenue*, 340 U.S. 534, 537 (1951) (taxpayer claiming constitutional immunity from tax has burden of establishing it).

This Court's standards are well-established and have been recently considered and applied by this Court. There is no need to revisit them.

B. The New Hampshire Supreme Court Applied The Standards Established By This Court And Correctly Held That Petitioners Did Not Show That Facial Discrimination Exists.

The New Hampshire Supreme Court correctly determined that Petitioners did not show that discrimination exists. *Caterpillar (N.H.)*, at Petitioners' App. 13a. The New Hampshire

Supreme Court compared the Business Profits Tax imposed upon the foreign members of the unitary group and unrelated domestic entities. *Caterpillar (N.H.)*, at Petitioners' App. 10a. It considered "the operation of other provisions of the . . . statute" under review. *Caterpillar (N.H.)*, at Petitioners' App. 5a –6a, 10a – 11a. It also imposed upon Petitioners the burden of showing that foreign commerce is more heavily taxed than domestic commerce. *Caterpillar (N.H.)*, at Petitioners' App. 8a.

Following the decisions of this Court, the New Hampshire Supreme Court correctly considered all of the provisions of the Business Profits Tax. It considered that New Hampshire completely excludes the income of foreign subsidiaries from the combined group's apportionable tax base, thus reducing the tax base and ensuring that none of the income recorded on the books of a foreign subsidiary is apportioned to New Hampshire.[9] This lower tax base lowers the New Hampshire tax.

When all of the provisions of the Business Profits Tax are taken into account, Petitioners cannot show facial discrimination. While the exclusion of a foreign subsidiary's factors increase the tax, the exclusion of its net income from the tax base decreases the tax. When both the apportionment formula and the entire tax base are considered, it is not possible to establish that the Business Profits Tax will be.

---

[9] The New Hampshire Supreme Court observed that Petitioners are taxed with respect to the royalties and interest received from their foreign subsidiaries just as they are taxed on any royalties and interest that they may receive from unrelated corporations. Petitioners' App. 10a - 11a. This identical treatment is significant because it shows that New Hampshire's Business Profits Tax is structured to avoid taxing the income of foreign subsidiaries. Just as New Hampshire's tax is structured to tax Petitioners only for Petitioners' income and not for income of unrelated corporations which make payments to Petitioners, New Hampshire's tax is structured to similarly avoid taxing Petitioners for the income of their foreign subsidiaries.

higher for a parent corporation with a foreign subsidiary than for a parent corporation with a domestic subsidiary. A parent corporation with a foreign subsidiary may pay more or less tax than a parent with a domestic subsidiary. Whether the tax is higher depends on many independent facts including: the income of the parent; the income of the subsidiary; the property, payroll and sales factors of the parent; the property, payroll and sales factors of the subsidiary; the amount of royalties and interest paid by the subsidiary to the parent; and the nature and amounts of other transactions between the parent and subsidiary. Whether the tax will be higher or lower for a parent with a foreign subsidiary depends on which of the infinite combinations of these elements is present in a particular case. *Caterpillar (N.H.)*, at Petitioners' App. 13a (citing *ASARCO Inc. v Idaho State Tax Comm'n*, 458 U.S. 307, 326-27 n.22 (1982)) (application of unitary-business principle is fact-specific). The fact that the tax may be higher or lower shows that the Business Profits Tax does not discriminate against foreign commerce.

Petitioners use a single example to illustrate their claim that New Hampshire's water's edge combination method of taxation discriminates against foreign royalties and interest. *See* Petition at 16-17. In their example, Petitioners first focus on the royalty and interest payments as separate items and then reclassify them as "Foreign Unitary Income" so that they have the appearance of comparability with the combined net incomes of Caterpillar's domestic subsidiaries. Petitioners then argue that a greater percentage of the foreign royalty and interest payments are taxed under the water's edge system. This attempt to isolate the payments of royalties and interest, and then argue that the apportionment factors will always be higher for the group with the foreign members, ignores the amount of income that is excluded from the tax base.

The operation of the entire Business Profits Tax statute on a water's edge group that receives royalties and interest paid

by a foreign subsidiary demonstrates that the treatment is neutral and nondiscriminatory. This different, nondiscriminatory treatment of a water's edge combination of a parent with a domestic subsidiary and a parent with an uncombined foreign subsidiary is explained in Examples 3 and 4 respectively. App. 12a-15a. The Appendix to this Brief contains additional examples, using perfectly plausible numbers, in which a group with a foreign subsidiary would pay less tax to New Hampshire than would an identical group with only domestic members. *See* App. 16a-21a. These examples further demonstrate that income and expenses of the foreign companies are excluded from the tax base and that only the factors of those companies whose income and expenses are included in the tax base are included in the calculation of the apportionment percentage. This is a neutral, logical, and symmetrical method of computing taxable income.

As they did in the court below, Petitioners fail to consider the operation of the entire Business Profits Tax statute in their analysis. Petitioners focus on the apportionment formula and a portion of the tax base, but only that portion which exists for companies receiving payments from foreign subsidiaries. No valid comparison between companies with foreign subsidiaries and companies with domestic subsidiaries is even possible as there is no comparable portion of the tax base for payments from companies with domestic subsidiaries. While in some cases a parent corporation's apportionment percentage is lower when the parent has a domestic subsidiary than when it has a foreign subsidiary, Petitioners' analysis is incomplete and incorrect because Petitioners only apply these percentages to the amount of any royalties and interest received from the subsidiaries.

Petitioners' analysis is contrary to the decisions of this Court due to their failure to consider the entire Business Profits Tax statute. *See Kraft*, 505 U.S. at 80-81; *Maryland v. Louisiana*, 451 U.S. at 756. Specifically, Petitioners fail to consider that

while the apportionment percentage is higher when a subsidiary is foreign, the apportionable tax base is lower because the income of the foreign subsidiary is excluded from the apportionable tax base of the combined group.

Review of the decision below is not necessary because the New Hampshire Supreme Court applied the standards established by this Court and correctly held that Petitioners did not show that discrimination exists.

C. Petitioners' Arguments Are Based On The Flawed Premise That All Payments From Foreign Subsidiaries To Members Of The Water's Edge Group Are Made Because Of The Group's Ownership And Control Of Those Subsidiaries.

Petitioners contend that, without "factor representation," the water's edge method employed in the Business Profits Tax facially discriminates against royalties and interest received from unitary foreign subsidiaries in violation of the Foreign Commerce Clause of the United States Constitution. The tax discriminates against foreign commerce, allege Petitioners, because royalty and interest received from unitary domestic subsidiaries is treated more favorably. At the New Hampshire Supreme Court, the Petitioners asserted that the cure to the problem was to include the foreign royalty and interest payor's property, payroll and sales in the water's edge groups' apportionment factor denominators to accurately reflect – in Petitioners' view – the "source" of the income.[10]

---

[10] In their Petition, it now appears that Petitioners are asserting that there should be total exclusion of foreign royalty and interest payments from the water's edge group. This was their theory at the trial court level. However, they abandoned that argument at the New Hampshire Supreme Court and should not be allowed to raise it in this Petition. *See* Petition at 18-19.

1. There Is No Factual Basis In The Record For Petitioners' Assertion That Royalty And Interest Payments Repatriate Unitary Income From Its Foreign Subsidiaries.

As noted in the Statement of Case, the factual foundation of this case is an agreed Stipulation of Facts. Nowhere in the Stipulation is it provided that royalty and interest payments from Petitioners' foreign subsidiaries actually constituted a form of distribution of the payor subsidiary's earned income. Indeed, the only controlling facts in the Stipulation concerning the nature of these payments is that the royalties were paid in exchange for licenses to use intellectual property, i.e., trademarks and technology, and that the interest paid was for intercompany loans. *See* Stip. ¶ 10, at App. 2a. The Stipulation actually supports the contrary characterization of those payments: they are the result of contractual obligations neither tied to nor dependent upon any notion of net income of the payor.

Caterpillar made similar statements to the Minnesota Supreme Court. The Minnesota Supreme Court rejected Caterpillar's attempt to recharacterize its intercompany interest and royalty payments as anything other than contractual obligations. *Caterpillar (Minn.)*, 568 N.W.2d at 696 n.6. As a result, the essential factual foundation to Petitioners' arguments in this case is missing.

2. There Is No Basis In Law For Petitioners' Assumption That Royalty And Interest Payments Have The Same Character As Dividends.

As noted previously, Petitioners argued to the New Hampshire Supreme Court that royalty and interest payments have the same character as dividends. While this argument is not clearly articulated in this Petition, it is certainly assumed. It is an assumption that this Court should reject.

"Royalty" is defined as a "a payment reserved by the grantor of a patent, lease of mine or similar right, and payable proportionally to the use made of the right by the grantee." *Black's Law Dictionary,* at 1496 (4th ed. 1968). It also means "a payment which is made to an author or composer by an assignee or licensee in respect to each copy of his work which is sold, or to an inventor in respect of each article sold under the patent." *Id.* "Interest" means "the compensation allowed by law or fixed by the parties for the use or forbearance or detention of money." *Id.* at 950. By common definition, then, royalties and interest are derived from contractual arrangement between the payor and the payee whereby the payor has the right to use certain property of the payee: intellectual property such as patents, trademarks, and licensed technology with respect to royalties; money or credits with respect to interest.

Under generally accepted accounting principles, royalties received represent revenue to the recipient and royalties paid expenses of the payor. *See* Donald E. Kieso and Jerry J. Weygandt, *Intermediate Accounting*, 568, 570, 572 (4th ed. 1983). Similar treatment is accorded to interest received and paid. Under federal income tax law, royalty and interest payments are expense deductions from gross revenues for the payor, 26 U.S.C. § 162, 163, and revenue items included in the gross income of the payee, 26 U.S.C § 61. The net effect of a payment of royalties or interest, regardless of whether the payor is related to the payee, is reduction of the payor's income and increase of the payee's.

Petitioners' previously open and now assumed mischaracterization of these payments as something other than contractual consideration is an attempt to force them into a role comparable to the net income of the domestic subsidiaries included in a water's edge combined return.

This mischaracterization does not consider that the royalties and interest received by Petitioners are income of the

combined group and it is the income of the combined group that is being measured, apportioned and taxed. When paid by the foreign subsidiary, the royalties and interest are not income of the subsidiary. Rather, they are expenses of the foreign subsidiary which reduce its income.

The New Hampshire Supreme Court correctly rejected the Petitioners' mischaracterization of the royalty and interest payments as income of the foreign-payors. The court properly determined the payments to be income of the domestic recipients. *Caterpillar (N.H.)*, at Petitioners' App. 11a – 12a. *Accord Caterpillar (Minn.)*, 568 N.W.2d at 696 n.6; *Caterpillar Financial Services Corp. v. Whitley*, 680 N.E.2d 1082 (Ill. Ct. App.), *appeal denied*, 686 N.E.2d 1158 (Ill. 1997).

The court below did not err and review is unwarranted.

III. The New Hampshire Supreme Court's Decision Does Not Conflict With Decisions Of Other State Appellate Courts.

There is no conflict among the lower courts, despite Petitioners' assertions to the contrary. The lower courts have all interpreted the *Kraft* decision the same way. The New Hampshire Supreme Court was only the most recent to issue its interpretation. The cases where lower courts have struck state taxes as discriminating against foreign commerce all involved tax systems that did not require combined reporting. *See Conoco, Inc. v. Taxation & Revenue Department*, 931 P.2d 730 (N.M. 1996) (holding that *Kraft* discrimination is not remedied by factor expansion), *cert. denied*, 117 S. Ct. 2497 (1997); *Dart Industries, Inc. v. Clark*, 657 A.2d 1062 (R.I. 1995) (statute indistinguishable from *Kraft*).

Since New Hampshire uses combined reporting, it does not discriminate. And, all state appellate courts that have reviewed this issue have held that water's edge combination systems do not discriminate against payments from foreign

sources. *See Caterpillar (Minn.)*, 568 N.W.2d at 701 (holding that Minnesota's water's edge system did not facially discriminate or unduly burden foreign commerce); *Caterpillar Fin. Servs. Corp. v. Whitley*, 680 N.E.2d 1082 (Ill. Ct. App.), *appeal denied*, 686 N.E.2d 1158 (Ill. 1997) (tax does not discriminate against royalties and interest from foreign subsidiaries where the total net income of domestic subsidiaries is include in apportionable income while the total net income of foreign subsidiaries is excluded); *E. I. Du Pont de Nemours & Co. v. State Tax Assessor*, 675 A.2d 82 (Me. 1996) (holding Maine's water's edge combined reporting method does not discriminate against dividends from foreign subsidiaries); *In re Morton Thiokol, Inc.*, 864 P.2d 1175 (Kan. 1993) (Kansas' water's edge combined reporting method does not facially discriminate against dividends from foreign subsidiaries).

In deciding this case, the court below correctly applied this Court's standards for determining discrimination under the Foreign Commerce Clause and the decisions of other state appellate courts are consistent with it.

IV. New Hampshire's Non-Discriminatory, But Different, Accounting For Foreign And Domestic Subsidiaries Is Justified.

Considering all of Petitioners' arguments, their protestations to the contrary notwithstanding, it is apparent that the real challenge is to the use of water's edge combination rather than worldwide combination. The logical consequence of Petitioners' arguments would be the adoption of worldwide combination – all unitary entities would then be combined. However, there are sound policy reasons why the federal government pressured the states into abandoning worldwide combination.

Combined reporting of corporate income was not the norm in New Hampshire or anywhere until relatively recently. The

constitutionality of combination came to this Court from the State of California and, in 1983, this Court ruled that California's use of worldwide combination and apportionment did not violate the Due Process and Commerce Clauses of the United States Constitution. *See Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). The Court stated that it has "long held that the Constitution imposes no single formula on the States" because precise territorial allocation of the income of a unitary business enterprise "is often an elusive goal, both in theory and practice." *Container*, 463 U.S. at 164.

Although worldwide combination and apportionment was held constitutional, courts, commentators, governments, and business have all recognized that the use of worldwide combination presents substantial problems. For example, worldwide combination combines the income and factors of both domestic and foreign corporations, including foreign corporations that are not required to report their activities on federal tax returns because they are beyond the reach of the taxing power of the United States. *See Container*, 463 U.S. at 184; 26 U.S.C. §§ 881-885. It thus presents a basic compliance problem. In addition, worldwide combination necessitates converting the diverse languages, currency, and accounting principles from around the world into the language, currency, and accounting principles of the United States, a substantial burden on taxpayers and the states. *See Barclays*, 512 U.S. at 313. Further, worldwide combination conflicts with the separate entity accounting system that the United States and foreign nations use for foreign corporations. *See Container*, 463 U.S. at 184. The use of worldwide combination by states has been opposed by virtually every developed country in the world, *see Barclays*, 512 U.S. at 324-25 n.22, and the states have been pressured not to employ it.

Under pressure from multinational companies and under the threat of federal legislation, states that previously adopted

worldwide combination and apportionment began to move away from it after the *Container* decision. Noted tax commentators have described this reaction:

> In an ironic twist of history, the victory of the California Franchise Tax Board in the *Container* worldwide apportionment case led to the demise of worldwide apportionment in some States and to its restriction in other States. The ink was hardly dry on the *Container* decision in 1983 when President Ronald Reagan responded to the relentless pressure of multinational enterprises, supported by foreign governments, by convening a Worldwide Unitary Taxation Working Group to review worldwide apportionment. In its 1984 report, the Working Group recommended the adoption by the States of legislation or administrative action that would limit unitary apportionment of both U.S. and foreign-based multinationals to U.S. waters edge income. In the event "there are not sufficient signs of appreciable progress by the States" in adopting the agreed principles, Secretary of the Treasury Donald Regan stated that he would recommend Federal legislation that "would give effect to a water's edge limitation."

1 Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, ¶ 8.16, at 8-185 (2nd ed. 1993) (footnotes deleted). Acting with "unusual legislative speed," states changed their laws to adopt some form of water's edge apportionment. *Id.* ¶ 8.16, at 8-185, 8-187. And, as the New Hampshire Supreme Court noted, "the water's edge method was adopted for the benefit of foreign businesses." *Caterpillar (N.H.)*, at Petitioners' App. 11a. Except for Alaska's special provision for oil, gas and pipeline companies operating there, no state requires worldwide unitary reporting. CCH State Tax Guide, vol. 1, ¶ 10-115 (3/97); CCH State Tax Reporter, Alaska, ¶ 12-404 (9/96).

The foregoing shows that strong policies and state interests justify the use of the water's edge combination method.

CONCLUSION

Based on the reasons set forth above, the State of New Hampshire Department of Revenue Administration and Stanley R. Arnold, Jr., the New Hampshire Commissioner of Revenue, respectfully request that this honorable Court deny the Petition for Writ of *Certiorari*.

Respectfully submitted,

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, COMMISSIONER

PHILIP T. MCLAUGHLIN
Attorney General
STEPHEN J. JUDGE*
Associate Attorney General
ANNE M. EDWARDS
Assistant Attorney General
Civil Bureau
N.H. Dept. of Justice
33 Capitol Street
Concord, New Hampshire
03301-6397
(603) 271-3658

JOHN F. HAYES
Revenue Counsel
N.H. Department of
Revenue Administration
45 Chenell Drive
Concord, New Hampshire
03302-0457
(603) 271-3400

Counsel for Respondents
**Counsel of Record*

February 22, 2000

No. 99-1214

IN THE

Supreme Court of the United States

CATERPILLAR INC., CATERPILLAR FINANCIAL SERVICES CORPORATION, AND SOLAR TURBINES INCORPORATED,

Petitioners,

v.

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION AND STANLEY R. ARNOLD, JR., THE N.H. COMMISSIONER OF REVENUE,

Respondents.

APPENDICES

APPENDIX A

IN THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS. JULY TERM, 1995

SUPERIOR COURT

93-E-609-B

CATERPILLAR INC., ET AL.,

Petitioners,

v.

THE NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION
AND STANLEY R. ARNOLD, JR.,
THE NEW HAMPSHIRE COMMISSIONER OF REVENUE

Respondents.

STIPULATION OF FACTS

It is hereby stipulated that for purposes of this case the following statements are accepted as fact and all exhibits referred to herein are incorporated in this Stipulation and made a part hereof; provided, however, that the parties may introduce other and further evidence not inconsistent with the facts herein stipulated, and provided further, that either party may object to any of the facts or documents herein on the grounds of materiality or relevancy. All other evidentiary objections are waived unless specifically expressed in this Stipulation. Unless the context

D. Unitary Intragroup Transactions

10. Caterpillar Inc. and certain other domestic members license their trademarks and technology in return for royalty payments, and provide intercompany loans, to foreign and domestic members of the Caterpillar Unitary Group.

11. In 1987, the following foreign members of the Caterpillar Unitary Group paid royalties and interest income to certain members of the 1987 Water's Edge Group in the following amounts:

FOREIGN MEMBER	ROYALTIES PAID	INTEREST PAID
Caterpillar Africa	$ 522,347	$ 175,039
Caterpillar Australia	808,429	2,170,318
Caterpillar Belgium	34,926,845	21,103
Caterpillar Brasil	0	2,256,621
Caterpillar Canada	6,094,516	323,933
Caterpillar China	0	0
Caterpillar Commercial N.V.	0	4,811
Caterpillar Far East	0	16,443
Caterpillar Financial Services N.V.	0	281,255
Caterpillar France	11,641,155	984,298
Caterpillar U.K. Ltd.	21,401,511	120,235
Caterpillar Overseas S.A.	4,677,895	241,676
Conek	366,808	2,357,790
P.T. Natra Raya	637,493	256,040
Solar Turbines Canada	0	52,002
Solar Turbines S.A.	0	0

These taxes were imposed by the foreign governments of the countries in which the foreign members of the Caterpillar Unitary Group (as defined in ¶ 3) were located. The withholding taxes paid with respect to the receipt of royalties and interest were paid by the members of the Water's Edge Group to the foreign governments. U.S. Federal law provides a foreign tax credit for foreign withholding taxes paid directly by the members of the Water's Edge Group. New Hampshire law does not provide a foreign tax credit for foreign withholding taxes paid. The withholding tax payments were not reported on the foreign income tax returns of the foreign members of the Caterpillar Unitary Group because these payments were made by the members of the Water's Edge Group. For Federal tax purposes, all of the members of the Water's Edge Group receiving payments elected to take a credit in respect of the foreign withholding taxes paid rather than a deduction.

15. Interest and royalties received by members of the Water's Edge Group were deducted on the foreign income tax return of the foreign member of the Caterpillar Unitary Group making the payment. On the federal income tax return of the member of the Water's Edge Group receiving the royalty and interest income, these amounts are treated as foreign source income. These amounts were included in the figure shown on Line 28 on the federal income tax return. New Hampshire uses Line 28 of the federal return to begin its calculations. These amounts are not subsequently eliminated on

the New Hampshire return. These amounts received are included in the New Hampshire apportionable income of the Petitioners.

16. In 1987, 1988 and 1989 members of the Water's Edge Group made interest payments to Caterpillar Inc. in the amounts of $10,910,515, $17,833,229 and $22,444,857, respectively.

E. Calculation of New Hampshire Business Profits Tax Liability

17. In each of the 1987, 1988 and 1989 tax years, New Hampshire law required the Water's Edge Group to calculate its New Hampshire BPT liability pursuant to the following, bifurcated process:

Step 1. Calculating New Hampshire's Water's Edge Taxable Business Profits

A. The federal taxable incomes (before net operating losses and other special deductions) of each of the Water's Edge Group members, less foreign dividends and Subpart F income (certain income earned by foreign subsidiaries that is treated as if earned directly by the U.S. parent), are combined to produce "New Hampshire Combined Net Income." All intragroup payments received by a Water's Edge Group member from other Water's Edge Group members (including interest and royalty payments, if any) are eliminated in making this calculation (i.e., such payments are treated as if they had not been made). Payments, including interest and royalty payments, received by a Water's Edge Group member from foreign members of the Caterpillar Unitary Group and

of any audit adjustments by the Internal Revenue Service which are agreed or finally upheld in an administrative or court proceeding.

Respectfully submitted,

NEW HAMPSHIRE DEPARTMENT OF REVENUE ADMINISTRATION, ET AL.

By their attorneys,

Jeffrey R. Howard
Attorney General

Martin P. Honigberg (No. 10998)
Assistant Attorney General
Civil Bureau
33 Capitol Street
Concord, N.H. 03301
(603) 271-3658

Jerome B. Libin
Steven M. Sobell
SUTHERLAND, ASBILL & BRENNAN
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 2004
(202) 383-0100

Mark P. Szpak
ROPES & GRAY
One International Place
Boston, Massachusetts 02110
(617) 951-7000

Counsel for Caterpillar Inc. et al.
Petitioners

Of Counsel:

Daniel J. Schlicksup
CATERPILLAR INC.
100 N.E. Adams Street
Peoria, Illinois 61629-4295

July 19, 1995

APPENDIX B

NEW HAMPSHIRE REVISED STATUTES ANNOTATED

TITLE V. TAXATION
CHAPTER 77-A. BUSINESS PROFITS TAX

RSA 77-A:6 (1996)

77-A:6. Returns, Declarations, and Combined Reporting.

I. Every business organization having gross business income in excess of $50,000 as defined by RSA 77-A:1, VI, during the taxable period, shall on or before the fifteenth day of the third month in the case of organizations required to file a United States corporation tax return, and the fifteenth day of the fourth month in the case of all other business organizations, following expiration of its taxable period, make a return to the commissioner. The commissioner of revenue administration shall adopt rules, pursuant to RSA 541-A, relative to the form of such return and the data which it must contain for the correct computation of taxable business profits and gross business income attributable to this state and the tax assessed on it. All returns shall be signed by the taxpayer or by its authorized representative, subject to the pains and penalties of perjury.

II. Every business organization shall in addition file a declaration of its estimated business profits tax for its subsequent taxable period; provided, however, if the estimated tax is less than $200, a declaration need not be filed; and provided further that a declaration shall be filed at the end of any quarter thereafter in which estimated tax exceeds $200. The declaration shall be filed when payments are due under RSA 77-A:7.

III. [Repealed]

IV. A business organization which is part of a water's edge combined group and required to report under this chapter shall file a return containing the combined net income of the water's edge combined group and such other informational returns as the commissioner shall require by rules adopted under RSA 541-A. The commissioner is authorized to impose the tax as though the entire combined net income of the water's edge combined group was that of one business organization or the commissioner may adjust the tax or income in such other manner as the commissioner shall determine to be equitable if the commissioner determines it to be necessary in order to clearly reflect the net income earned by such organization from business done in this state. This provision shall not authorize the application of worldwide combined reporting except as provided in RSA 77-A:2-b, II.

HISTORY: SOURCE. 1970, 5:1. 1971, 515:6. 1973, 544:9; 579:1, 4, 5. 1975, 166:1; 439:34, 36. 1977, 593:3, 4; 605:1. 1981, 128:17; 445:8, 568:65, I. 1986, 153:6. 1991, 163:43, IX. 1993, 202:1, eff. July 1, 1993. 1996, 154:3, eff. July 1, 1996.

AMENDMENTS --1996. Paragraph IV: Substituted "the commissioner" for "he" in three places in the second sentence.

--1993. Paragraph I: Substituted "$50,000" for "$12,000" in the first sentence.

--1991. Paragraph III: Repealed.

--1986. Paragraph IV: Amended generally.

--1981. Paragraph I: Chapter 128 deleted "under such regulations and in such form or manner as the commissioner may prescribe" following "return to the commissioner" in the first sentence and rewrote the second sentence.

Chapter 445 inserted "and gross business income attributable to this state" following "business profits" in the second sentence.

Chapter 568 substituted "$12,000" for "$6,000" in the first sentence.

Paragraph II: Chapter 445 deleted "at the same time the return is filed as required by paragraph I" preceding "every business", "estimated taxable business profits and" following "declaration of" and inserted "and" preceding "provided further" in the first sentence, rewrote the second sentence and made minor changes in punctuation throughout the paragraph.

Paragraph III: Added by ch. 445.

Paragraph IV: Amended generally by ch. 445.

--1977. Paragraph I: Chapter 605 inserted "in the case of organizations required to file a U.S. corporation tax return and the fifteenth day of the fourth month in the case of all other business organizations" preceding "following expiration" in the first sentence.

Chapter 593:3 substituted "fifteenth day of the third month" for "the first day of the fifth month" in the first sentence.

Paragraph IV: Chapter 593:4 substituted "thirtieth" for "fifteenth" preceding "day".

--1975. Paragraph II: Chapter 166 added the two provisos at the end of the first sentence.

Chapter 439:36 deleted "unless for good cause the commissioner permits the taxpayer to make a lesser estimate" following "therewith" in the second sentence.

Paragraph III: Repealed by ch. 439:34.

--1973. Chapter 544 substituted "commissioner" for "commission" wherever it appeared in pars. I-III.

Chapter 579 deleted "commencing July 1, 1970" preceding "every business organization" and added "having gross business income in excess of six thousand dollars as defined by RSA 77-A:1, VI, during the taxable period" thereafter in the first sentence of par. I, added the second sentence of par. II and added par. IV.

--1971. Paragraph II: Deleted "except those anticipating a gross business profit of less than ten thousand dollars during its subsequent taxable period" following "organization" in the first sentence.

Paragraph III: Added.

Applicability of 1993 amendment. 1993, 202:2, eff. July 1, 1993, provided that section 1 of the act, which amended par. I of this section, shall apply to returns and taxes due on account of taxable periods ending after June 30, 1993.

Applicability of 1986. 1986, 153:9, provided that 1986, 153:6, would apply to returns and taxes due on account of taxable periods beginning after June 30, 1986.

Purpose of 1986 amendment. 1986, 153:1, provided: "This act amends existing law by limiting the application of the business profits tax to the water's edge by eliminating overseas business organizations from subjection to this tax. However, it is not the intent of this legislation to alter those basic premises of New Hampshire taxation policies which follow the federal method of calculating taxable income, particularly when such policies or procedures are intended to further New Hampshire concerns with equal and proportional treatment of taxpayers."

APPENDIX C

Calculating New Hampshire Business Profits Tax

TAX BASE:

federal taxable income ± state adjustments = adjusted gross business profits

APPORTIONMENT:

NH property everywhere / property	+	NH payroll everywhere / payroll	+	NH sales everywhere / sales	+	3

= apportionment percentage

TAX CALCULATION:

adjusted gross business profits X apportionment percentage = taxable business profits

taxable business profits X tax rate = tax

Example 1
(Separate Entity Accounting and Apportionment)

Separate entity accounting is the way most businesses file their New Hampshire Business Profits Tax returns, becuase most filers are not part of a larger unitary group. If the business operates only in New Hampshire, calculation of the tax is easy. Net income, as adjusted, is multiplied by the tax rate to determine the tax. If the company operates in more than one state, however, apportionment is required.

Assume company P has total sales of $150,000 and expenses of $120,000 (net income of $30,000), with property, payroll, and sales in New Hampshire of $500, $1,000, and $5,000, respectively, compared to total property, payroll, and sales of $40,000, $20,000, and $150,000, respectively. P's tax base would be its $30,000 net income. Its apportionment percentage would be calculated as follows:

APPORTIONMENT PERCENTAGE:

Property: NH	500
Everywhere	40,000
Payroll: NH	1,000
Everywhere	20,000
Sales: NH	5,000
Everywhere	150,000

Percentage Calculation:	Property	500/40,000	=	1.2500%
	Payroll	1,000/20,000	=	5.0000%
	Sales	5,000/150,000	=	3.3333%
	Average (total % divided by 3)			3.1944%

TAX CALCULATION:

Net Income	X	Apportionment %	=	Taxable Profits
$30,000	X	3.1944%	=	$958.32
Taxable Profits	X	Tax Rate	=	Tax
$958.32	X	8%	=	$76.67

Example 2
(Combined Reporting and Apportionment)

Assume that company P (the same company as in Example 1) has a domestic subsidiary S. They are the only two members of a unitary group. Assume, as above, that P has $150,000 in sales and $120,000 in expenses ($30,000 net income), while S has $7,000 in sales and $5,000 in expenses ($2,000 net income). Calculation of the group's tax base is a simple matter of adding the net income of the two companies: $30,000 plus $2,000, for an aggregate of $32,000.

For calculating the apportionment percentage, assume P has the same factors as above and that S has no property, payroll, or sales in New Hampshire. S has totals of $1,000 in property, $800 in payroll, and $7,000 in sales. The calculation of the group's apportionment percentage and tax would be as follows:

APPORTIONMENT PERCENTAGE

	Parent P	Sub S	Combined
Property: NH	500	0	500
Everywhere	40,000	1,000	41,000
Payroll: NH	1,000	0	1,000
Everywhere	20,000	800	20,800
Sales: NH	5,000	0	5,000
Everywhere	150,000	7,000	157,000

Percentage Calculation:	Property	500/41,000	=	1.2195%
	Payroll	1000/20,800	=	4.8077%
	Sales	5,000/157,000	=	3.1847%
	Average (total % divided by 3)			3.0706%

TAX CALCULATION

Combined Net Income	X	Apportionment %	=	Taxable Profits
$32,000	X	3.0706%	=	$982.60

Taxable Profits	X	Tax Rate	=	Tax
$982.60	X	8%	=	$78.61

Example 3
(Combination with Intra-Group Interest Payments)

The effect of an intra-group payment of interest or royalties can be seen by modifying the previous example by having Subsidiary S make a $500 interest payment to Parent P. The combined group's tax base does not change from the previous example. The $500 interest payment is a receipt by P and a corresponding expense deductible by S, so the net income of the group is the same.

Calculation of the apportionment percentage also does not change, but an adjustment must be made to avoid a miscalculation. Because the calculation of the sales factor uses gross receipts, not net profits, the sales factor figures would be overstated unless the $500 interest payment were backed out of the calculation—"eliminated" in the parlance of taxation. The calculation of the group's tax base, apportionment percentage, and tax is as follows:

	Parent P	Sub S	Elimination	Combined
TAX BASE:				
Receipts:				
Net Sales	150,000	7,000		157,000
Interest	500			500
Total	150,500	7,000		157,500
Deductions:				
Other Expenses	(120,000)	(5,000)		(125,000)
Interest		(500)		(500)
Net Income	30,500	1,500		32,000
APPORTIONMENT PERCENTAGE:				
Property: NH	500	0		500
Everywhere	40,000	1,000		41,000
Payroll: NH	1,000	0		1,000
Everywhere	20,000	800		20,800
Sales: NH	5,000	0		5,000
Everywhere	150,500	7,000	(500)	157,000

Percentage Calculation:				
	Property	500/41,000	=	1.2195%
	Payroll	1,000/20,800	=	4.8077%
	Sales	5,000/157,000	=	3.1847%
	Average (total % divided by 3)			3.0706%

TAX CALCULATION:

Combined Net Income	X	Apportionment %	=	Taxable Profits
$32,000	X	3.0706%	=	$982.60

Taxable Profits	X	Tax Rate	=	Tax
$982.60	X	8%	=	$78.61

Example 4
(Water's Edge Combination)

When foreign corporations are included in a conglomerate, international politics can affect the way states levy taxes. One way to determine income that can be taxed by a particular state is separate entity accounting and apportionment as in Example 1 above. Most states, however, require combined reporting. Worldwide combination would be exactly the same as Examples 2 and 3. Water's edge combination is a variant of worldwide combination.

Under water's edge apportionment, all members of a unitary group are combined except those that qualify as "overseas business organizations" under RSA 77-A:1, XV, i.e., foreign businesses. The unitary ties between overseas business organizations and the water's edge members of the unitary group are ignored for purposes of determining the water's edge group's taxable income. The foreign companies' income is not included in determining the water's edge group's tax base, and the foreign companies' property, payroll, and sales are likewise excluded from the calculation of the water's edge group's apportionment percentage. Royalty and interest payments between foreign members and water's edge members are treated as if the foreign members were unrelated to the group.

Therefore, for taxpayers like Caterpillar, such income is included in the water's edge group's tax base and is represented in the denominator of the sales factor in the apportionment percentage—it does not appear in the numerator because the water's edge recipients are not domiciled in New Hampshire. The process can be demonstrated with an example that assumes the subsidiary in the previous example is a foreign corporation and thus not a member of the water's edge group—it is now designated Sub F. The calculation of the group's tax base, apportionment percentage, and tax would be as follows:

	Parent P	Sub F
TAX BASE:		
Receipts:		
Net Sales	150,000	7,000
Interest	500	
Total	150,500	7,000
Deductions:		
Other Expenses	(120,000)	(5,000)
Interest		(500)
Net Income	30,500	1,500
APPORTIONMENT PERCENTAGE:		
Property: NH	500	0
Everywhere	40,000	1,000
Payroll: NH	1,000	0
Everywhere	20,000	800
Sales: NH	5,000	0
Everywhere	150,500	7,000

Percentage Calculation:				
	Property	500/40,000	=	1.2500%
	Payroll	1,000/20,000	=	5.0000%
	Sales	5,000/150,500	=	3.3223%
	Average (total % divided by 3)			3.1908%

TAX CALCULATION:

Combined Net Income	X	Apportionment %	=	Taxable Profits
$30,500	X	3.1908%	=	$973.18

Taxable Profits	X	Tax Rate	=	Tax
$973.18	X	8%	=	$77.85

PARENT WITH COMBINED DOMESTIC SUBSIDIARY

	Parent	Domestic Sub	Elimination	Combined
Tax Base				
Receipts:				
Net Sales	150,000	50,000		200,000
Royalties & Interest	20,000			20,000
Gross Receipts	170,000	50,000		220,000
Deductions:				
Other Expenses	(120,000)	(15,000)		(135,000)
Royalties & Interest		(20,000)		(20,000)
Net Income	50,000	15,000		65,000
Apportionment				
Factors:				
Property : NH	500	0		500
Everywhere	40,000	10,000		50,000
Payroll: NH	1,000	0		1,000
Everywhere	40,000	10,000		50,000
Sales: NH	5,000	0	0	5,000
Everywhere	170,000	50,000	(20,000)	200,000
Percentage Calculation:				
Property %				1.0000%
Payroll %				2.0000%
Sales %				2.5000%
Total (divided by 3)				1.8333%

Tax Calculation

Combined Profits	Apportionment Percentage	Taxable Profits	Tax (at 8%)
65,000	1.8333%	1,191.67	95.33

PARENT WITH UNCOMBINED FOREIGN SUBSIDIARY

	Parent	Foreign Sub
Tax Base		
Receipts:		
Net Sales	150,000	50,000
Royalties & Interest	20,000	
Gross Receipts	170,000	50,000
Deductions:		
Other Expenses	(120,000)	(15,000)
Royalties & Interest	0	(20,000)
Net Income	50,000	15,000
Apportionment		
Factors:		
Property : NH	500	0
Everywhere	40,000	10,000
Payroll: NH	1,000	0
Everywhere	40,000	10,000
Sales: NH	5,000	0
Everywhere	170,000	50,000
Percentage Calculation:		
Property %	1.2500%	
Payroll %	2.5000%	
Sales %	2.9412%	
Total (divided by 3)	2.2304%	

Tax Calculation

Apportionable Profits	Apportionment Percentage	Taxable Profits	Tax (at 8%)
50,000	2.2304%	1,115.20	**89.22**

PARENT WITH COMBINED DOMESTIC SUBSIDIARY

	Parent	Domestic Sub	Elimination	Combined
Tax Base				
Receipts:				
Net Sales	500,000	100,000		600,000
Royalties & Interest	50,000			50,000
Gross Receipts	550,000	100,000		650,000
Deductions:				
Other Expenses	(300,000)	(25,000)		(325,000)
Royalties & Interest		(50,000)		(50,000)
Net Income	250,000	25,000		275,000
Apportionment				
Factors:				
Property : NH	1,000	0		1,000
Everywhere	100,000	10,000		110,000
Payroll: NH	2,500	0		2,500
Everywhere	300,000	10,000		310,000
Sales: NH	5,000	0	0	5,000
Everywhere	550,000	50,000	(50,000)	550,000
Percentage Calculation:				
Property %				0.9091%
Payroll %				0.8065%
Sales %				0.9091%
Total (divided by 3)				0.8749%

Tax Calculation

Combined Profits	Apportionment Percentage	Taxable Profits	Tax (at 8%)
275,000	0.8749%	2,405.91	192.47

PARENT WITH UNCOMBINED FOREIGN SUBSIDIARY

	Parent	Foreign Sub
Tax Base		
Receipts:		
Net Sales	500,000	100,000
Royalties & Interest	50,000	
Gross Receipts	550,000	100,000
Deductions:		
Other Expenses	(300,000)	(25,000)
Royalties & Interest	0	(50,000)
Net Income	250,000	25,000
Apportionment		
Factors:		
Property : NH	1,000	0
Everywhere	100,000	10,000
Payroll: NH	2,500	0
Everywhere	300,000	10,000
Sales: NH	5,000	0
Everywhere	550,000	50,000
Percentage Calculation:		
Property %	1.0000%	
Payroll %	0.8333%	
Sales %	0.9091%	
Total (divided by 3)	0.9141%	

Tax Calculation

Apportionable Profits	Apportionment Percentage	Taxable Profits	Tax (at 8%)
250,000	0.9141%	2,285.35	**182.83**

PARENT WITH COMBINED DOMESTIC SUBSIDIARY

	Parent	Domestic Sub	Elimination	Combined
Tax Base				
Receipts:				
Net Sales	150,000	7,000		157,000
Royalties & Interest	500			500
Gross Receipts	150,500	7,000		157,500
Deductions:				
Other Expenses	(150,000)	(5,000)		(155,000)
Royalties & Interest		(500)		(500)
Net Income	500	1,500		2,000
Apportionment				
Factors:				
Property : NH	500	0		500
Everywhere	25,000	2,000		27,000
Payroll: NH	1,000	0		1,000
Everywhere	30,000	5,000		35,000
Sales: NH	5,000	0	0	5,000
Everywhere	150,500	7,000	(500)	157,000
Percentage Calculation:				
Property %				1.8519%
Payroll %				2.8571%
Sales %				3.1847%
Total (divided by 3)				2.6312%

Tax Calculation

Combined Profits	Apportionment Percentage	Taxable Profits	Tax (at 8%)
2,000	2.6312%	52.62	4.21

PARENT WITH UNCOMBINED FOREIGN SUBSIDIARY

	Parent	Foreign Sub
Tax Base		
Receipts:		
Net Sales	150,000	7,000
Royalties & Interest	500	
Gross Receipts	150,500	7,000
Deductions:		
Other Expenses	(150,000)	(5,000)
Royalties & Interest	0	(500)
Net Income	500	1,500
Apportionment		
Factors:		
Property : NH	500	0
Everywhere	25,000	2,000
Payroll: NH	1,000	0
Everywhere	30,000	5,000
Sales: NH	5,000	0
Everywhere	150,500	7,000
Percentage Calculation:		
Property %	2.0000%	
Payroll %	3.3333%	
Sales %	3.3223%	
Total (divided by 3)	2.8852%	

Tax Calculation

Apportionable Profits	Apportionment Percentage	Taxable Profits	Tax (at 8%)
500	2.8852%	14.43	1.15